

where no explicit threat is made. Sorting out the reasons for disaffiliation or other punishment can be difficult if not impossible. The only way genuinely to assure that affiliates maintain sufficient autonomy to program to the needs and interests of their local communities is to see that they maintain some degree of economic bargaining power in their dealings with their network.

In short, while the relationship between networks and affiliates is multi-faceted, on balance it is one in which the network has substantial leverage, which, without Commission restraint, would likely be used even more effectively than it is today to reduce the independent voices of the affiliates. Moreover, regardless of whether the networks have true market power over affiliates, the network-affiliate relationship provides a host of new avenues through which the cable operator can exploit its unquestioned market power.

C. Cable-Network Combinations Would Suppress  
Competition In Local Markets And Inhibit The  
Independent Programming Judgment Of Affiliates.

Cable systems and networks today have substantial market leverage over local stations and substantial incentives to exercise that power. Permitting cable-network combinations clearly would exacerbate this already difficult situation. For non-affiliated competitors, the primary tools of the cable-network would be the threat of carriage denial or

manipulation of channel positioning. For affiliated stations, the primary tools would be the threat of disaffiliation, reduction in compensation, and reduction in the scope of exclusivity for network programming.<sup>15/</sup> The inevitable result will be to undercut competition in the local video marketplace and suppress the independent programming judgment of local stations.

(1) Reduction in competition with non-affiliated stations: The networks and the cable systems compete with local stations in the local market for viewership, for local advertising dollars and for national advertising dollars. It is obvious that, in the absence of any must carry or channel-positioning restraints, the cable-network would have both the means and additional incentive to discriminate against competing network and independent stations.<sup>16/</sup>

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<sup>15/</sup> And should the rules prohibiting networks from syndicating off-network fare or representing stations in national sales be repealed, these issues, too, would be added to the negotiations.

<sup>16/</sup> Proponents have asserted that no rational cable-network would discriminate against other network affiliates or independents by dropping them or putting them on "inaccessible" tiers. They reason that such a move would cost the cable-network subscribers and that the value lost would exceed the value gained through additional viewers because cable subscribers are worth substantially more than viewers and because the cable-network would garner only a fraction of the frustrated viewers. See, e.g., CBS Further Reply Comments, B.C. Docket No. 82-434 at 16-17 (November 22, 1988). There are a number of inadequacies with this reasoning. First, it applies only to network affiliates and

(2) Reduction in affiliate independent judgment:

Given the substantial evidence that even today affiliate autonomy is being eroded or eliminated in many markets through the exercise of network power, it is inconceivable that adding the clout of the local cable operator to the network's side of the bargaining table will not lead to further network intrusions into "local" station time. The cable-network operator will have even greater credibility in threatening disaffiliation.

This enhanced credibility will result in part, as noted above, because the cable-network will have a greater pool of alternative stations. In addition, as even the National Telecommunications and Information Administration ("NTIA") has acknowledged, in a growing number of markets, cable penetration and homes passed will be sufficiently high that the threat of complete by-pass will be quite real. Reply

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"large independents" who make up the "most popular and widely viewed programming". Id. at 17. Marginal independents and start-ups would not, presumably, cost the cable system subscribers. Second, it makes the extreme assumption that the discrimination would take the form of total exclusion or extreme inaccessibility. There are many less drastic ways a cable system can make it more or less difficult for viewers to locate particular services.

Third, that this same reasoning applies to already vertically integrated cable services is not reassuring. Contrary to CBS's claim in 1988 that there was no evidence of programming discrimination by vertically integrated cable companies, there is now substantial evidence of just such discrimination. Cable Report at 118-130.

Comments of NTIA, B.C. Docket No. 82-434 at 2 (October 22, 1988). Because cable subscribers are worth substantially more than broadcast viewers, it is entirely plausible to project a situation where the gains in subscribers from granting network "exclusivity" to a cable system will exceed the viewer losses to the network. The number of markets in which this will be a factor will only increase over time as cable operators "cluster" their systems geographically.<sup>17/</sup>

Moreover, a primary value brought to the networks by the affiliates is local news programming and the development and maintenance of a unique station "identity." As more and more cable systems initiate their own local news operations, OPP Report at 81, the relative value of local station news operations declines (at some point becoming negative) and the capability of the cable system to replace that programming grows.

In sum, there is every reason to believe that the costs of repeal of the cable-network rule to competition,

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<sup>17/</sup> Proponents have asserted that the threat of by-pass is fanciful, as evidenced by the fact that networks by agreement with cable systems could by-pass affiliates today but do not do so. CBS Further Reply Comments at 25-27. The obvious answer is that because they do not own the cable systems they would not retain all of the increased value to the cable operator in the form of additional subscribers; indeed, because of the obvious market power of the cable operators it is highly unlikely that the network would obtain a proportionate share of the additional value.

diversity, local station autonomy and universal availability will be substantial.

D. The Case for Repeal Has Not Been Made.

In the face of the clear and unequivocal public interest benefits of the cable-network rule, surely the burden is on those who would repeal it to identify substantial and concrete reasons for repeal. But in the nine years that the proposal to repeal the rule has been pending, proponents of repeal have yet to make their case.

1. Repeal Is Not Warranted By The Fact That Networks No Longer Have Power Over Cable And Cable Programmers In The National Video Programming Market.

The rule was adopted at a time when cable was a fledgling industry and the broadcast networks had a "predominant" share of the national television audience. The rule was designed initially to assure that the networks did not utilize their then-substantial power in the programming and distribution markets to restrain the development of the cable industry and cable programming networks or reduce diversity in local markets. Second Report, supra.

It has been obvious for some time that neither the cable industry nor the national cable programming industry need any further protection from the networks. It is this

insight which has fueled the calls for the rule's repeal. See, e.g., First Notice, citing Final Report, FCC Network Inquiry Special Staff at page III-158 et seq. (October 1980) ("Network Inquiry Report"); K. Gordon, J. Levy & R. Preece, FCC Policy on Cable Ownership 107 (Staff Report, FCC Office of Plans and Policy, November 1981) ("OPP Cable Report"). And it is this issue that the proponents of repeal continue to attack with elaborate and sophisticated economic analyses, to the virtual exclusion of other discussion. See, e.g., Further Comments of CBS, Inc., B.C. Docket No. 82-434 at 9-17 (October 24, 1988); Comments of Capital Cities/ABC, B.C. Docket No. 82-434 at 2-3 (October 24, 1988).

While it may be galling to the proponents of repeal, the answer to the charge that this is a regulation in search of a rationale is that it has found one and an important one at that. The rapid ascendancy of the cable industry and the continuing imbalance in the competition between cable and broadcasting has made the rule an essential check on cable power in the local video marketplace. Regulatory serendipity or not, the continued bleating about the loss of the rule's initial purpose is nothing more than an attack on a straw man.

2. "Workable" Competition To Cable In  
Local Markets Has Not Developed.

The fact that the rule serves to check cable power has not gone entirely unnoticed by the proponents of repeal. Their response has been to assert that both the national and local video markets in which cable competes are or soon will be competitive. Thus in 1981, the OPP Cable Report found that the video market in which cable operated was "workably competitive," that competition in this market was likely to increase in the future, and that, "given these competitive circumstances, [as well as the intervention of increasingly sophisticated franchise authorities,] cable operators have substantial incentives to maximize the services provided by their systems in order to maximize their profits." OPP Cable Report, quoted in First Notice, 91 F.C.C.2d at 79.

The First Notice found this analysis persuasive. It concluded that "[c]hanges in the competitive nature of the local video markets since the ownership ban was adopted are similarly notable [to those in the national programming market]." First Notice 91 F.C.C.2d at 83. It singled out in particular the birth of such promising new "alternative delivery systems" as subscription television ("STV") (then serving 33 million households) and the multipoint distribution service ("MDS") (serving 16 million households), both of which

had circulation numbers comparable to those of cable (then only 23 million households). Id. at 83-4. It also asserted that

[i]t seems likely that the number and quality of video delivery competitors for cable television systems will increase in the near future [e.g., additional STV and MDS stations, and the imminent introduction of the newly created low power television ("LPTV"), MMDS and DBS], thereby further intensifying the pressure on cable operators to effectively compete by providing the optimum mixture of services.<sup>18/</sup>

Obviously, these cheery scenarios have not panned out. Neither STV nor MDS made a major dent in the video market; both are now extinct. MMDS (now wireless cable) and DBS, while potentially significant players, remain largely undeveloped or on the horizon. LPTV has had little or no competitive impact. And broadcast stations, handicapped by the compulsory license and severe ownership restrictions, have proven to be marginal competitors to the multichannel cable operators.

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<sup>18/</sup> Id. at 84. The Network Inquiry Report, which also advocated repeal, was essentially silent on the issue of what effect repeal would have in the local marketplace. It simply assumed that the networks, subject to some national limit on aggregate audience reach, could engage in "some integration" into cable in a way that would have "no adverse effect on competition in any market." Network Inquiry Report at III-163. The report did not specify how much integration was "some" or how the anticompetitive potential could be avoided.



To be fair, these analyses were made before the MSOs and cable programmers achieved their most explosive growth and before the industry underwent its extensive consolidation and vertical integration.<sup>19/</sup> Just as significantly, these analyses preceded the elimination of must carry and the passage of the Cable Communications Policy Act of 1984 which gave the MSOs essentially unfettered control over tiering, station carriage and channel-positioning decisions. There simply is no longer any question as to the existence of cable's market power.<sup>20/</sup>

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<sup>19/</sup> It was sufficiently plausible at the time that repeal of the rule was endorsed not only by the three networks but by the National Association of Broadcasters.

<sup>20/</sup> The Second Notice, too, was prompted by a government study calling for repeal, this time from the NTIA. See NTIA, Video Program Distribution and Cable Television: Current Policy Issues and Recommendations, NTIA Rep. 88-233 (June 1988) ("NTIA Report"). But by this time the ascendancy of cable was quite visible and the Second Notice acknowledged that the NTIA study "cited evidence of a growing concern that cable may now be the dominant video medium vis-a-vis broadcast television in many markets." Second Notice at ¶ 6. Despite this concern, the NTIA Report advocated repeal, again focusing solely on the national cable programming market. NTIA Report at 72-73. A year later, however, the evidence of local market power was clear to the FCC and the data in the OPP Report confirm those findings.

3. Franchise "Competition" And Local  
Franchise Authorities Will Not Restrain  
Cable Power.

The First Notice also perceived an important check on cable power to be the "dramatic increase in the level of competition among prospective system operators at the franchising stage" and the restraints on local system programming decisions imposed by "increasingly competent local franchising authorities." First Notice at 88. The significance of "franchise competition" was, of course, questionable even when it existed. It is dependent upon the desire and ability of local franchising authorities to police cable's relationship with local stations. While one would hope that local franchise authorities would place a high priority on the promotion of competition to cable and preservation of a fair shake for local broadcast stations, their political and economic agenda make this unlikely. Cf. NTIA Report at 19 (decrying franchise authorities' coziness with cable operators and ineffectiveness at promoting competition). And even if they displayed an optimal level of concern, they no longer have the capability to act. Congress, less enamored than the Commission of the "increased competence" of franchising authorities, in the 1984 Cable Act largely stripped those authorities of the ability to regulate

the programming decisions of their franchisees. See, e.g., 47 U.S.C. § 544.

In any event, "franchise competition" is essentially at an end. Long-term monopoly providers are ensconced in nearly every market and the prospects for "overbuilders" and other multichannel providers remain inchoate.

4. No Meaningful Benefits Of Repeal Have  
Been Identified.

While the costs associated with repeal are clear, the benefits remain vague and unspecified. The OPP Report contains little more than the following non sequitur:

[A]llowing combinations between broadcasters and other media, as long as they did not decrease the competitiveness of local broadcast markets, could allow efficient use of programming and other resources. . . . Rules that prevent the vertical integration of the major broadcast networks into program production and syndication, despite the fact that their competitors appear to find such integration valuable, also cause broadcasters to operate under a competitive handicap and should be reconsidered. In particular, the Commission should eliminate its broadcast network-cable cross-ownership ban.

OPP Report at 171 (emphasis added).

The affiliates agree wholeheartedly that the networks should be allowed to integrate into the programming and production business to a substantially greater extent than they have been or that the Commission has recently proposed to

permit them to be. But the cable-network rule does not relate to the networks' integration "backward" into their suppliers, it concerns their forward integration into distribution. This is a separate and distinct market, and one in which both the networks and the cable operators have considerable market power. And as to this market, the OPP Report's caveat that cross-media combinations should be encouraged only so "long as they did not decrease the competitiveness of the local broadcast market" begs the very question at hand.

In the First Notice, the Commission theorized that repeal of the rule "might result" in "significant efficiencies." First Notice at 87. It speculated that these efficiencies would flow from being able to reduce programming risks and costs by amortizing those risks and costs over a greater number of distribution outlets, create economies of scale "since overhead costs may be spread vertically as well as horizontally" and use "management talents" more intensively and efficiently. Id.; see also CBS Comments, supra, at 17-19. Similarly, the Second Notice repeated the conclusory assertion of the NTIA Report that repeal could result in efficiencies such as "using programming units for both cable and broadcast operations." Second Notice at ¶ 6, citing NTIA Report at 72-3.

The breadth and generality of these speculations make it difficult to establish definitively that they are utterly without merit. But there are certainly reasons to believe that these efficiencies, to the extent they exist, are minor.

First, the networks have never been precluded from owning or investing in cable programming services. And two of the networks, NBC and Cap Cities/ABC, are already among the largest and most aggressive cable programmers in the business. There is, then, no reason to believe that there are large management-talent or "overhead" economies of scale on the program production side that are being precluded by the networks' inability to own cable systems.<sup>21/</sup>

Second, to the extent there are true efficiencies of management, and not just increased market power, these efficiencies accrue to the networks as station owners, not as programmers. Current market structure for non-network, and thus unrestricted companies, reveals that any such efficiencies do not appear to be overwhelming. While there are certainly a number of companies which own both broadcast

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<sup>21/</sup> To the extent that NTIA is referring to joint cable-broadcast productions, again the networks are not precluded from engaging in such ventures except to the extent to which they run afoul of the financial interest and syndication rules.

stations and cable systems, they are by no means the rule or even the predominant structure in the industry.

That these synergies would be relatively modest would not be surprising. Broadcast stations require relatively modest investments in equipment and technical upkeep; cable systems are highly capital intensive.<sup>22/</sup> Broadcast stations spend very few resources on viewers; cable operators devote a substantial part of their budget to marketing, billing and customer relations (not to mention relations with local franchise authorities).

The two areas where broadcast and cable management do overlap, sales and programming, also have substantial differences. Sales is still a small part of the cable operation, and programming decisions by the station owners as to how to program a specific station are very different than the calculus as to what programming services to put on a multichannel system.

This is not to say that some efficiencies may not conceivably accrue to a cable-network operation. But it is to say that the proponents have not identified efficiencies that

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<sup>22/</sup> See OPP Report at 170 (broadcast stations spend, on average, only 9 percent of their budget on engineering and from 21.6 to 50 percent on "general and administrative expenses," a catch-all category excluding only engineering, programming and production, news, sales, and advertising and promotion).

are likely to be significant or that will justify the clear and present dangers to competition and diversity represented by repeal.

5.     The Threat Of A Major MSO-Network  
Combination Is Real.

It also seems clear that the consequences of repeal would more likely be a mega-acquisition of a network by an MSO or vice versa and not the gradual acquisition by a network of a modest complement of cable systems.

It now has been revealed that at the precise time the Second Notice was being commented upon, Capital Cities/ABC and Time, Inc., the latter now the second largest cable operator in the country, were negotiating a merger at the precise time the Second Notice was put out for public comment. See K. Auletta, Three Blind Mice 557 (1991). Indeed, the parties had already named the new company and reportedly were prevented from consummating the merger solely because of the Commission's refusal to repeal the cable-network rule. See id. Subsequently, NBC also held merger talks with Time, Inc. See id. at 401.

The situation today does not appear to be substantially different than it was in 1988. Recent press reports have speculated repeatedly that both NBC and CBS are

"on the block."<sup>23/</sup> Thus, if the Commission repeals this rule, the result likely will be yet another large step in the vertical and horizontal concentration of the cable industry.

E. "Safeguards" Are Not The Solution.

In an implicit acknowledgment that complete repeal of the rule would create the potential for anticompetitive conduct, the networks and others have at various times proposed that the repeal be subject to "safeguards" against the abuse of market power by a cable-network operator.<sup>24/</sup> Thus far these proposed safeguards have fallen into three categories: (1) must carry and channel positioning protection; (2) by-pass protection; and (3) national ownership restrictions.

The affiliates do not believe that the Commission will or even can develop safeguards which are realistic and administrable, yet effective. Must carry would certainly be an essential constraint. But, as the Commission is well aware, must-carry provisions stand on treacherous

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<sup>23/</sup> See The TV Networks in Play, Broadcasting, November 11, 1991, at 3 ("Wall Street analysts say CBS and NBC are 'on the block,' but nobody's buying").

<sup>24/</sup> See, e.g., Remarks of Chairman Alfred C. Sikes Before the International Radio & Television Society Newsmaker Luncheon, September 19, 1991, 1991 LEXIS 5003; see also Comments of the City of New York, B.C. Docket No. 82-454, at 9 (October 24, 1988).



constitutional terrain. While a must carry provision grounded in the need to protect against this type of anticompetitive abuse may be more likely to withstand judicial scrutiny than must carry generally, it is by no means assured that it will pass constitutional muster.

Similar infirmities adhere to channel-positioning guarantees. Moreover, because of cable's rapidly growing channel capacity,<sup>25/</sup> and its multiple-tiering capability, any channel-positioning rule short of total control by the local station (a solution not likely to be acceptable to the cable-networks), will inevitably be extraordinarily complex and require frequent amendment to be effective. And stations will remain vulnerable to cable system discrimination through discriminatory pricing and marketing techniques.

The issue of "by-pass" protection is even more complex. When the networks speak of by-pass protection, it appears that they mean only that the cable-network entity would agree not to distribute its broadcast network exclusively on cable in that market, e.g., not to by-pass all local stations. But, as argued earlier, a cable system might well find it profitable in certain circumstances to affiliate with more remote or technically inferior stations than would a

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<sup>25/</sup> Channel-compression technology could well lead to a tripling of cable channel capacity in the next five years. See OPP Report at 53.

"pure" network.<sup>26/</sup> This would expand the pool of stations eligible to compete for the affiliation, greatly enhancing the already disproportionate bargaining power of the network.

An alternative would be to require the cable-network to maintain the affiliation with its existing affiliate. If this were to be mandated regardless of the affiliate's performance, it is (a) highly doubtful that this would be acceptable to the networks and (b) of questionable net efficiency to the network-affiliate system. It is in any event unfair to the rest of the stations in the market who are thereby forever precluded from competing with that station for that affiliation. Yet, establishing a mechanism to permit the network to disaffiliate for performance reasons will lead to a mare's nest of administrative entanglements and litigation.

National ownership caps seem largely inapposite in the context of fears of anticompetitive behavior on the local level. Such caps have apparently been proposed to ease the fears of affiliates, and particularly the production community, that one or more of the networks will be purchased by one of the largest MSOs. Again, however, the affiliates' fears arise primarily from the fear of abuse in their local

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<sup>26/</sup> Just as networks could well have the incentive to by-pass local stations entirely, the switch to a station with a marginal technical facility would be attractive to the cable operator to drive its cable penetration.

markets; it will be small solace to those affiliates whipsawed by their network and their cable system to know that they are but a select few.

Even if sound and administrable must carry, channel-positioning and by-pass protections were developed, they would not assure that a local affiliate would be immune from coercion by its cable-network. As described above, the station-cable and affiliate-network relationships are complex and changing rapidly in ways that are not foreseeable. Should broadcasters obtain the right, for example, to bargain with cable systems over retransmission rights, a station affiliated with a network which owns its local cable system would find itself in the absurd position of bargaining over retransmission rights with the cable operator and then bargaining with that same operator over what share of those revenues, if any, would go to the network. Is it even remotely conceivable that these negotiations would be "arms-length" and that the affiliate would obtain a fair share of the proceeds?

Also on the table between the stations and the networks are such issues as compensation, clearances and the geographic and temporal scope of exclusivity. Unless the Commission were inclined to sit at the bargaining table with the affiliates and their cable-networks, it is difficult to

see how the Commission could truly prevent cable-networks from using their market power to disadvantage the affiliates in some significant respect. Safeguards are, then, little more than an illusion, useful in theory, useless or even counterproductive in application. The Commission should retain the current structural standard.

### III. CONCLUSION

The local broadcasting system is in trouble. This proceeding will serve the salutary purpose of signalling that significant regulatory relief is in order. The Commission is, however, powerless to grant the most significant relief needed: ending the cable subsidy which flows from the compulsory license. The Commission has needlessly inflicted further damage to the local broadcast system by refusing to let the networks integrate efficiently into program production.

Repeal of the cable-network rule would be nothing less than a regulatory "triple-whammy" for local stations. It would also be a remarkably perverse result. The Commission has just found that the networks, standing alone, have such substantial market power with respect to Hollywood giants such as Sony/Columbia that they must be subjected to rigid program restrictions. For the Commission to turn around and find that

the networks, in combination with local cable operators, would not together have an unhealthy degree of influence over individual affiliates even in the smallest markets in the country makes no sense. Even if such a step would in some way assist the networks, that assistance would be bought at the price of damaging the unique American system of local broadcasting and endangering the core values of localism, diversity and universality that system has long sought to engender.

Respectfully submitted,

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